



Has There Been an Investment Gap in France and Europe since 2007?

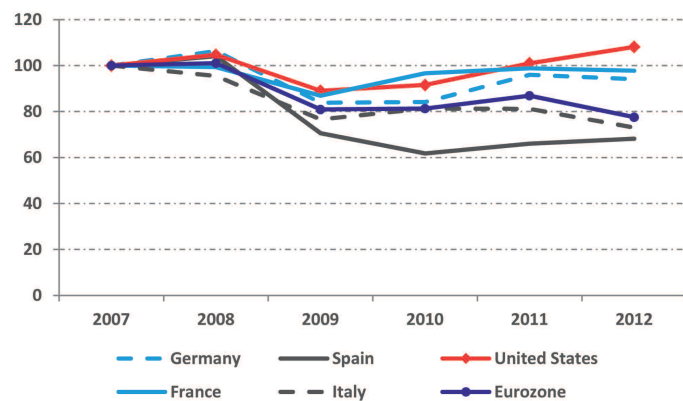
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The slowdown in the eurozone recovery since spring 2014 triggered a debate on investment in Europe, following the election to the European parliament in May.

From 2007 to 2013, despite an initial phase in which investment was relatively resilient, the eurozone accumulated a large investment gap with respect to the United States. Spain and Italy, notably, have experienced a very sharp reduction in investment in all areas, while the situation in France and Germany is harder to assess.

At a time when the eurozone is facing a shortfall of aggregate demand and major structural challenges, catching up on investment would seem to be a balanced recommendation.

Gross fixed capital formation in the manufacturing sector (volume)



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INTRODUCTION

On July 15, Jean-Claude Juncker, the new president-elect of the European Commission, announced a 300 billion euro investment program for 2015-2017 that symbolises the political importance of the debate. However, assessments and recommendations for investment within the eurozone, and in France in particular, are currently incomplete.

The term 'investment gap' is ambiguous. Have there been delays in public investment, in infrastructure for example, or rather in investment by companies whose productive capital has become too old or simply unsuitable for the 21st century economy? Does the gap have to do with the difficulties faced by small and medium-sized enterprises in obtaining financing, or does it also concern major groups? Do households also face an investment gap, particularly concerning housing?

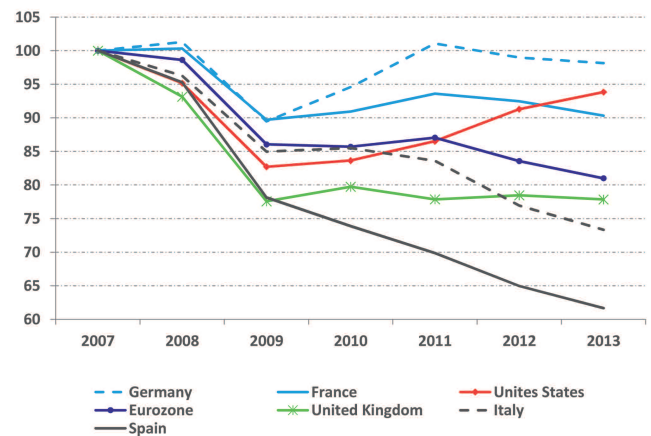
In the longer term, the global attractiveness of Europe as an investment destination will determine the flow of investment and the choice of sites for new job-creating activities. This calls for an evaluation of investments in infrastructure that are typically, but not exclusively, financed with public funds.

In this context, public policy can intervene at several levels to close the investment gap. First, by removing obstacles to private investment - both regulatory hindrances and obstacles linked to the unpredictability of relative prices, fiscal policy, etc. Second, by accelerating public investments that can be anticipated for the medium term.

STALLED INVESTMENT IN THE EUROZONE SINCE 2007

Since the outburst of the financial crisis, the share of investment (gross fixed capital formation, or GFCF) in GDP has declined in all developed economies. Although the eurozone initially resisted better than the United States, a slowdown began in 2011 while GFCF in the United States started to recover. There was a marked decline in Italy and Spain, while the situation in France and Germany stabilised quickly without recovering.

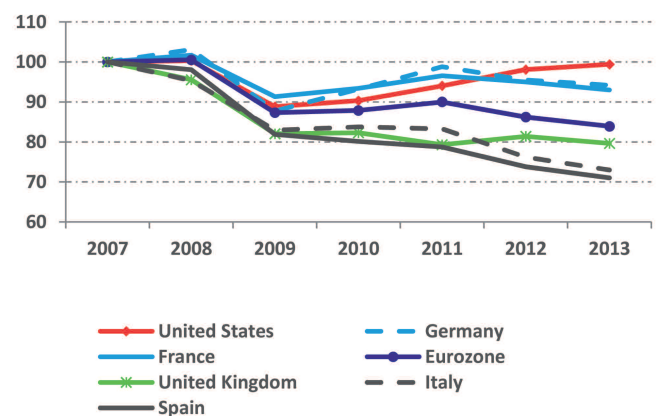
FIGURE 1 - GROSS FIXED CAPITAL FORMATION (VOLUME)



Note: Investment in terms of national accounts. All GFCF data are based on 2005 and do not take into account the recent revision based on 2010.
Source: Eurostat.

Sluggish growth of investment in the housing sector - which affected the countries that experienced a real estate bubble prior to the economic downturn - contributed only partially to this decline. The most serious risk threatening future growth is a potential gap in private productive capital investment.

FIGURE 2 - GROSS FIXED CAPITAL FORMATION EXCLUDING HOUSING (VOLUME)



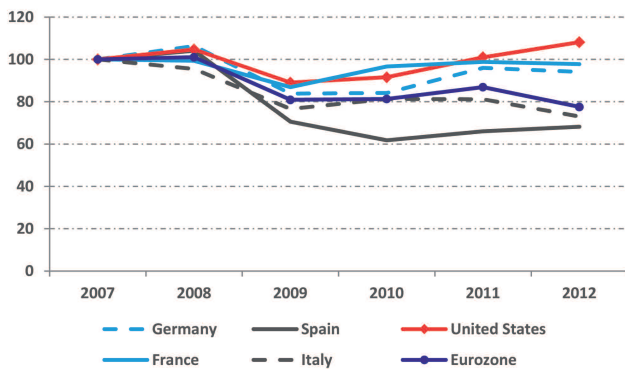
Sources: OECD, Eurostat and Bureau of Economic Analysis.



The rate of investment in non-financial companies (value added/GFCF) highlights a sharp and continuing slowdown in capital investment throughout the eurozone, although the situation varies widely.

In the manufacturing sector, fixed productive capital formation has held up rather well in France and Germany, while Italy and Spain are far behind. Conversely, recovery had begun in the United States by 2010, and by 2012 the rate of investment in manufacturing had surpassed its pre-2007 level by 10%.

FIGURE 3 - GROSS FIXED CAPITAL FORMATION IN THE MANUFACTURING SECTOR (VOLUME)



Sources: Eurostat and Bureau of Economic Analysis.

SLOWER GROWTH IN SPENDING ON ICT AND R&D

GFCF in information and communications technology (ICT) shows that the sector tended to be hit less hard by the economic downturn and is experiencing a faster recovery than investment in general. But while the eurozone has recently shown signs of weak improvement, growth in the United States is already strong.

Given the weight of ICT in total investment (about 15% in Europe, 18% in the United States), these technologies cannot reverse the overall trend. But as they are the cornerstone of the third industrial revolution, a steady rate of

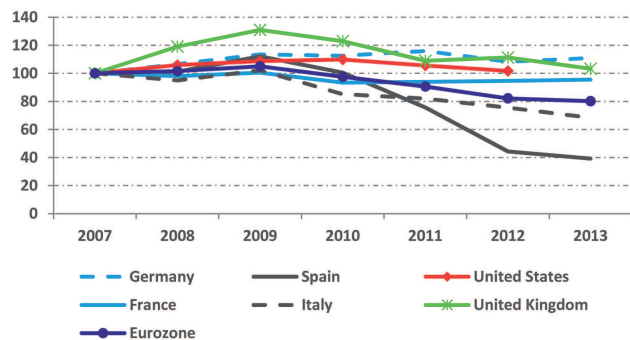
investment plays a determining role in the increased efficiency that is at the heart of tomorrow's growth.

Spending in research and development has also grown at a slower pace. Lagging R&D investment in the eurozone has impeded modernisation of production facilities and equipment, particularly in Spain and Italy, with the likely result that these southern countries will face difficulties in returning to their pre-crisis level of potential growth.

REDUCED INVESTMENT IN INFRASTRUCTURE IN SOUTHERN EUROPE

Meanwhile, public investment in infrastructure has dropped sharply in the southern eurozone countries since 2007, while remaining relatively stable in France and Germany. In France, the GDP share of public investment is particularly high compared to the European average.

FIGURE 4 - GROSS FIXED CAPITAL FORMATION IN THE PUBLIC SECTOR (VOLUME)



Sources: OECD and Eurostat.

In addition to public investment, overall spending on infrastructure also includes private and semi-public spending, especially investments in energy. In the eurozone, despite a strong downward trend in Spain and Italy, investment in infrastructure is consolidating, notably thanks to French dynamism.

CONCLUSION

As Europe debates the role of investment both as a short-term tool for boosting economic recovery and as a factor of productivity, assessment of very recent developments (2014) indicates that the eurozone's investment gap with respect to the United States is accelerating, with Spain and Italy showing a sharp decline in investment.

For France and Germany, assessment is more difficult. Germany's chronic underinvestment in the public sphere has intensified during the downturn, while France has made poor investment choices, neglecting high-quality productive capital formation (especially R&D) in favour of investment in non-forward-looking sectors (notably real estate).

This situation will restrain growth potential in two ways:

- In the short term, underinvestment or poorly oriented investment made by eurozone companies compromises their ability to bounce back and reach the 'technological frontier' that would allow European economies to move up on the global value chain.
- In the medium term, public underinvestment reduces the attractiveness of the eurozone countries and, therefore, their ability to attract investment.



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